

Information Regarding FICA for Medical Residents

What are FICA Taxes?

Federal Insurance Contributions Act (“FICA”) tax consists of two separate taxes (social security taxes and medicare taxes) imposed on employees’ wages. Any FICA tax that is due on the wages of an employee is split between the employer and the employee. The FICA provisions are found in the Internal Revenue Code (IRC) and the Treasury regulations issued by the Internal Revenue Service (IRS).

What is the “Student Exception” to FICA?

The IRC provides an exception from FICA for “service performed in the employ of . . . a school, college, or university . . . if such service is performed by a student who is enrolled and regularly attending classes at such school, college, or university.” Under this “student exception,” FICA taxes do not apply on an employee’s wages if the following two requirements are met: (1) the employee is a “student” and (2) the employer is a “school, college, or university.” If either of those requirements is not met, the student exception does not apply to exclude the employee’s wages from FICA taxes.

Are Medical Residents “Students” for Purposes of the Student Exception to FICA?

Pre-April 1, 2005 Period: Prior to April 1, 2005, the Treasury regulations provided that an employee had the status of a “student” for purposes of the student exception to FICA if the employee performs services for a school, college, or university “as an incident to and for the purpose of pursuing a course of study” at that school, college, or university. During all of this pre-April 2005 period, although medical residents were not specifically identified in the regulations, the IRS maintained a steadfast position that medical residents did not qualify as “students” for purposes of the student exception and, as such, FICA taxes were due on the wages of medical residents.

Post-March 31, 2005 Period: The IRS issued new Treasury regulations that were effective April 1, 2005. In the new regulations, the IRS set forth certain factors that indicate a lack of student status (e.g., the employee is working 40 or more hours per week, the employee carries less than a full-time course workload, the employee is a licensed professional employee, the employee is eligible for employee benefits). In an example in the 2005 Treasury regulations, the IRS states specifically that the services of a full-time medical resident performed as part of a medical residency program in a medical specialty do not qualify for the student exception to FICA because they are full-time employees. The IRS further states in the regulations that “the fact that some of [the medical resident’s] services have an educational, instructional, or training aspect does not affect this conclusion.” Those 2005 regulations are currently still in effect.

When Is an Organization that Employs Medical Residents a “School, College, or University” for Purposes of the Student Exception to FICA?

Pre-April 1, 2005 Period: Prior to April 1, 2005, the Treasury regulations relating to the student exception to FICA did not define “school, college, or university.” The regulations stated simply that the term “school, college, or university” is to be “taken in its commonly or generally

accepted sense.” Therefore, an organization that employs medical residents would be considered a “school, college, or university” during this pre-April 1, 2005 period for purposes of the student exception to FICA if the organization would be considered a school, college, or university in the generally accepted sense.

Post-March 31, 2005 Period: In the Treasury regulations issued by the IRS effective April 1, 2005, the IRS defined more specifically a “school, college, or university” for purposes of the student exception to FICA. Those revised regulations provide that an organization is a school, college, or university if “its primary function is the presentation of formal instruction, it normally maintains a regular faculty and curriculum, and it normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on.” In addition, through incorporation of the definition of an educational institution found in section 170(b)(1)(A)(ii) of the IRC, the regulations further provide that a “school, college, or university” for purposes of the student exception to FICA “does not include organizations engaged in both educational and non-educational activities unless the latter are merely incidental to the educational activities.” Therefore, under the 2005 Treasury regulations, an organization that employs medical residents will qualify as a “school, college, or university” for purposes of the student exception to FICA only if the educational activities of the organization are the primary function of the organization and all other activities of the organization are merely incidental to the organization’s educational activities. Those 2005 regulations are currently still in effect.

The IRS Changed its Position for Pre-April 1, 2005 Periods Five Years Later

The IRS announced on March 2, 2010, that it would allow refunds for FICA taxes imposed on the wages of medical residents for periods ending before April 1, 2005. In its announcement, the IRS stated that it had “made an administrative determination to accept the position that medical residents are excepted from FICA taxes based on the student exception for tax periods ending before April 1, 2005, when new IRS regulations went into effect.” The IRS did not specify in its announcement on what basis it considered a medical resident to be a “student” for this pre-April 1, 2005 period or on what basis it considered an organization that employed medical residents to be a “school, college, or university” for this pre-April 1, 2005 period. The IRS announcement does not affect the IRS’s position on whether medical residents are covered by the student exception to FICA for any period on or after April 1, 2005.

This announcement by the IRS was made well after the deadline for filing a refund claim for any pre-April 1, 2005 period. As such, this IRS announcement has practical application to a medical resident or its employing organization only if the medical resident or the employer had timely filed a refund claim for any pre-April 1, 2005 period before the IRS announced its changed position in 2010. Otherwise, because the statute of limitations had passed by the date of the IRS announcement, no claim for refund can be filed by any medical resident or employing organization to take advantage of the new announced IRS position.

Important Case Pending in the United States Supreme Court

On November 8, 2010, the U. S. Supreme Court heard oral arguments in *Mayo Foundation for Medical Education and Research v. United States*, a case involving whether the wages of medical residents of the Mayo Foundation are subject to FICA for the post-March 2005 period. The *Mayo* case involves the question of the validity of the 2005 Treasury regulations relating to the student exception from FICA.

Notwithstanding that the 2005 regulations define both “student” and “school, college, or university” for purposes of the student exception, only the portion of those Treasury regulations relating to the definition of “student” is in front of the Supreme Court in *Mayo*. Despite its critical importance to the student exception from FICA, neither the government nor the Mayo Foundation argued the definition of “school, college, or university” in the case. The only importance the parties or the Supreme Court attached to “school” during the argument was that, if medical residents were determined to be “students,” it would create a dichotomy within the medical profession because medical residents who work for hospitals that are not operated by schools, colleges, or universities would not be exempt from FICA even though their work was as educational as that of medical residents who work for hospitals operated by schools, colleges, or universities.

With respect to whether a medical resident should be considered a “student,” the attorney for the Mayo Foundation argued generally that the IRS’s categorical declaration in the 2005 regulations that a medical resident working 40 (or more) hours a week cannot be a student is arbitrary and unreasonable, and that a medical resident is a student because his residency is a requirement to practice medicine and, therefore, essentially educational in nature. In defense of the IRS regulation, the government argued that medical residents who are full-time employees should be treated just like other full-time employees notwithstanding that their service as residents is educational in some respect. Chief Justice Roberts commented:

[T]his [is] basically a very familiar situation of an apprentice who is both an employee and [] a student, and to try to draw the line in some categorical way doesn’t make sense. The only way you can draw the line is to have somebody say: This is going to be the line. And if anybody is going to say it, it ought to be the IRS.

A decision in the *Mayo* case will likely not be issued until sometime in 2011. If the Supreme Court holds in *Mayo* that the IRS regulation is valid and full-time medical residents are not “students,” then the FICA student exception will not be available to any full-time medical residents. If the Supreme Court holds that all medical residents are “students,” then the FICA exception will be available to medical residents, but only if they are employed by “schools, colleges, or universities.” If the portion of the 2005 Treasury regulations defining “school, college, or university” remains undisturbed (because it was not challenged in *Mayo*), an employing organization will not be considered to be a “school, college, or university” if the organization’s primary function is not educational, and its medical residents would not be exempt from FICA under the student exception even if those medical residents are “students.”

What Is CHRISTUS Doing With Respect to FICA for Medical Residents?

Based on the IRC, the Treasury regulations, and the IRS position, CHRISTUS has consistently paid the employer share of FICA taxes on the wages of medical residents employed by CHRISTUS entities and withheld the medical resident’s share of FICA taxes imposed on those wages.

With respect to the pre-April 2005 period for which the IRS announced that it would allow refunds for FICA taxes for medical residents or employing organizations that had refund claims on file with the IRS at the time the IRS made its announcement, although it is not clear whether CHRISTUS or its medical residents will qualify for these FICA refunds, CHRISTUS is in the

process of trying to obtain FICA refunds on behalf of itself and its medical residents for (i) the first quarter of 2005 (for medical residents employed by CHRISTUS Spohn Health System Corporation (dba Spohn Memorial Hospital), Santa Rosa Family Health Center, and CHRISTUS Health Gulf Coast (dba St. Joseph Hospital)) and (ii) calendar year 1997 (for Spohn Memorial Hospital). Any medical resident employed by one of those organizations during the relevant period should email their contact information including mailing address to CHRISTUS.TaxTeam@christushealth.org along with the name of the facility and year(s) they served as resident. CHRISTUS is not eligible to obtain a refund of either the employer portion or the employee portion of FICA tax for any other pre-April 2005 period.

For periods on and after April 1, 2005, CHRISTUS has filed (and is continuing to file) “protective” claims for refunds with the IRS in the event that CHRISTUS and the medical residents employed by CHRISTUS during those periods become entitled to FICA refunds based on the Treasury regulations and the Supreme Court’s decision in the *Mayo* case, which is expected in 2011.